CHAPTER 11

CONCLUSION & SUGGESTIONS

Developing petroleum countries presumably act from motives of enlightened national interest, pursuant to which they struggle to gain control over their own natural resources, especially petroleum, which provide crucial income to ensure a minimum standard of living for their citizens and to achieve a suitable level of development. Therefore, these countries have slowly, over the entire 20'h century been in the process of disentangling themselves from colonial relationships which served the western world's interests.

Petroleum companies and their home states (predominately developed industrialised states) act to protect their interests in the petroleum industry and gain as much profit as possible from this sector, irrespective of the consequences for developing petroleum countries. To achieve this goal, petroleum companies, sustained by their home states, began at the beginning of the 20th century to tie up the natural resources sector of developing countries in chains of unequal contracts. Under such contracts, petroleum companies received the exclusive rights to explore, exploit, produce, sell and transport petroleum. These contracts were typically for a long period of time, and the royalties due to the host state were generally negligible not exceeding a few cents per barrel. At the same time, these contracts contained multiple clauses and provisions which aimed to provide a considerable level of security for the interests of petroleum companies, such as the stabilisation clause.

Against this complex background, arbitration was implemented as a mechanism for solving disputes arising out of petroleum transactions. Unfortunately, in the beginning arbitration served only to protect petroleum companies' interests, and was not implemented as a just method of settling disputes. The petroleum arbitrations of the last century provide evidence for this. Therefore, arbitration was not welcomed by developing countries, since these countries perceived international arbitration to be biased in favour of western petroleum companies. The Libyan petroleum arbitrations are considered as the most flagrant proof of bias in the arena of international commercial arbitration. The refusal of Latin American countries to settle disputes by tribunals other than domestic courts is the best example of developing countries' scepticism and suspicion towards international arbitration. For in general, the authority of the host state was dismissed, whether in terms of its courts' jurisdiction or its laws. The mostly self-serving belief which
prevailed in the last century was that the host state’s law was inadequate to deal with such sophisticated contracts, and that therefore the interests of petroleum companies would be threatened under the jurisdiction of the host state’s court.

Opinions on the nature of petroleum contracts and subsequently the applicable law are varied and no single one has gained overwhelming acceptance. In fact, western scholars competed in providing a description of the characteristics of petroleum contracts and subsequently the law which should govern these contracts. One opinion holds that foreign companies which conclude long-term contracts with developing states need protection from the intervention of the host state, and therefore these contracts should be delocalised in terms of substantive law. Others have argued that these contracts are international treaties which should be governed by international law and any violation of these contracts should be considered a violation of (public) international law. A third opinion states that these contracts have international elements and therefore should be governed by the general principles of law recognised by civilised nations. Others believe that these contracts are quasi-international agreements and accordingly that they themselves constitute their own legal order and proper law. Some have suggested that these contracts should be governed by transnational law such as *lex mercatoria* or UNIDROIT Principles.

However, it could be argued that most of these opinions are based on old arbitration awards rendered in the middle of the 20th century, which presumed that petroleum exporting countries (host states) lacked a sophisticated legal infrastructure. Nowadays, these countries possess advanced legal systems, and many have enacted new laws (most of which were guided by western laws mainly of civil law origin) dealing with different aspects of national or international legal issues. Consequently, the allegation that host states lack a comprehensive legal system appropriate for the settlement of disputes arising out of complicated contracts such as petroleum contracts is no longer tenable.

Hence, it could be argued that the law of the host state may well be the applicable law to the merits of a dispute in petroleum arbitration. This opinion derives its authority from a number of facts, in addition to the point made above concerning the adequate sophistication of these countries’ legal infrastructure. First, the doctrine of sovereign immunity provides that a country cannot be a subject of a law other than its national law without its consent. Second, in theory and in case law, developing countries possess authority to control their natural resources by applying
Their domestic laws. Third, the doctrine of private international law gives priority to the law of the closest connection or most significant relationship. In petroleum contracts there is no ambiguity regarding the most closely connected factors, since all these factors, the subject matter of the contract, the place of performance of the contract, take place within host state. Fourth, the intention of the host states, whether made clear in certain petroleum contracts, in the OPEC Resolution of 1968, or in petroleum laws issued subsequently, is in favour of host state law. Having said that and according to the suggested method (semi-localization theory) if the host state's law is inadequate to govern the dispute, arbitrators can apply directly other law or rules which they consider applicable without any recourse to the conflict of laws rules i.e. (voie directe).

It is an undisputed fact that the intention of the contracting parties or the doctrine of party autonomy is the cornerstone in arbitration, since as it has been argued the answer to every dispute is to be found prima facie in the contract itself. However, this doctrine exists in the sphere of private parties, where all the contracting parties are on an equal footing in terms of bargaining power. The contractual relationship between states and private parties, especially in the petroleum industry, may not always be one of equality because there may be some political and financial pressures on the state (particularly developing countries) which lead it to compromise its autonomy. Furthermore, this doctrine has been ignored in previous petroleum arbitrations, where the law of the host state was dismissed.

Nonetheless, it is true that in certain ways host state law may be an inadequate method for dealing with disputes, and a specialized forum may be more appropriate. The Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID) has been established to create a neutral international forum which on the one hand, provides facilities for conciliation and arbitration of investment disputes between contracting states and nationals of other contracting states, and on the other hand, provides a system for the enforcement of its awards.

---


2 It was argued that “such countries [developing countries] have often in the past been at a considerable disadvantage in negotiating contractual arrangements with foreign countries, because severe international asymmetries in the political and economic balance of power enabled the latter to impose restraints on a government’s ability adequately to protect its own interests”, Edith Penrose/ George Joffe/ Paul Stevens, “Nationalisation of Foreign-owned Property for a Public Purpose: An Economic Perspective on Appropriate Compensation”, 55 Modern Law Review 351,367,353 (1992).
However, petroleum disputes should not fall directly under the ICSID Convention for several reasons. First, the petroleum industry is a mix of legal and political industry and petroleum contracts are sui generis investment contracts; second, the ICSID Convention allows its members to exclude certain disputes from its jurisdiction, and it appears that petroleum disputes are commonly excluded; third, the enforcement of ICSID awards in practice normally faces several obstacles because a state can invoke the doctrine of sovereign immunity in order to sidestep enforcement. Hence, awards which are rendered by ICSID tribunals are no different from awards made by other tribunals.\(^3\)

Although national courts may seem to be the obvious alternative, there are many reasons why litigation before a national court is not always the proper way to solve petroleum disputes: the difference in legal status of the contracting parties; the fact that the national court may not always be qualified to solve such disputes; arbitration has become one of the most common methods of disputes resolutions especially between parties from different countries. The increase in disputes which have been resolved by arbitral tribunals is perhaps evidence of their effectiveness. Despite the scepticism of developing countries, towards international arbitration the establishment of a specialized institution by petroleum exporting and importing countries may create an acceptable framework for these countries.

It has been argued that the petroleum industry has its own particular characteristics and that petroleum contracts are distinct from other types of investment contracts. Consequently, petroleum arbitration differs from normal international commercial arbitration. The petroleum industry is an international industry by nature, and political issues have more influence on this industry than any other; petroleum affects the daily life of all nations, whether the petroleum producing countries who are concerned about the availability of petroleum and their petroleum income, or the industrialized countries which are concerned about energy supply. Although the petroleum industry is high risk, it is also considerably profitable. Generally, investment agreements are time specific, namely they exist for an agreed time only, their scope is specified, and these agreements

are based on feasibility studies which enable the investors to calculate their profits and also their losses.

However, petroleum contracts typically extend over a longer period of time than other investment contracts. Petroleum companies have much power in terms of negotiation, which is reflected in the agreements, especially in the scope of the agreements such as the wide range of rights, or the size of the concession area. The third distinguishing characteristic of the petroleum industry is what is called "cost recovery", which simply means that all petroleum companies have the right to recover all their exploration costs once petroleum has been discovered. Accordingly, it could be argued that petroleum disputes require specific forms of dispute resolution because of the peculiarity of petroleum agreements, and the role and impact of the petroleum industry in the economy of many countries, especially developing countries.

However, does the petroleum industry need a specialized forum or an arbitration institution for the settlement of disputes which arise out of its transactions of the sector? If the answer is positive, where should the institution be located and what scope should it have? Moreover, what form should the institution take? Should it be established by a regional convention between the Arab petroleum countries, or by an international convention between all petroleum producing countries? What is the position of petroleum companies in this framework? Furthermore, should this institution be as an inter-governmental institution such as the International Centre for Settlement of Investment Disputes (ICSID), or private, non-governmental institution? If it takes an inter-governmental form, is there any possibility of establishing a joint venture relationship between this institution and ICSID, or the Organisation of the Petroleum Exporting Countries (OPEC)? Or is there any possible involvement of the International Chamber of Commerce (ICC) or the World Trade Organisation (WTO) or the African -Asian Legal Cooperation in its activities? In addition, does this institution need special rules namely its own, or it may adopt other rules i. e. UNCITRAL Arbitration Rules?

Having raised such questions, it could be argued that the establishment of a specialist institution to settle petroleum disputes may decrease the tensions between producing and consuming countries, by reassuring producing countries of its independence while protecting, within reason, the legitimate expectations of each party. At the same time, this institution may play a considerable role in terms of utilising petroleum for the mutual benefit of all principal actors’ i. e. producing countries, consuming countries and petroleum companies.
Indeed, the time is ripe for the establishment of an international arbitration institution for the settlement of disputes which arise out of petroleum - or even more out of all energy sector transactions. The petroleum dispute settlement institution which I propose here should take the form of an international convention between all petroleum producing and all consuming countries in order to attach to the institution global appeal, and the petroleum companies should come under the umbrella of their home states, since these latter cannot be a part of international convention.

The convention should provide that, once it is ratified by a prescribed number of states (say major producing and major consuming countries) it shall come into force. In principal the convention should recognize the sovereign equality of all contracting parties. Moreover, the convention should fill the gaps inherent in other arbitration conventions, such as the New York Convention and the ICSID Convention, particularly those gaps which concern the enforcement of awards. For example, the contracting states to this convention should consider decisions (other than final awards) rendered by tribunals in the context of this institution as a final and binding award. Furthermore, this award should be enforced in the same manner as local awards, without review by national courts. This simply means that a state cannot invoke the doctrine of sovereign immunity, even at the stage of enforcement.

The convention should be guided by the following principles:

1) It should recognize the principle of separability of arbitration agreements;

2) It should also recognize the doctrine of Pacta Sunt Servanda, and therefore a state cannot terminate a petroleum contract with a petroleum company, except in very limited circumstances and only for public purposes, in a non-discriminatory manner, accompanied by payment of prompt, adequate and effective compensation;

---


3) Nonetheless, the convention should take into account the extent to which petroleum companies consider the interests of host states while they perform their contracts, or the extent to which they practice any type of discrimination against the employees of the host state, etc;

4) The performance of contracts by petroleum companies should be transparent and therefore petroleum companies should be responsible for any inaccurate information that they may provide to the host state, especially in terms of petroleum reserves. In cases of falsified information, the company should be fully responsible for paying just compensation to the host state.

The institution which will be established pursuant to this convention should have its seat/headquarters in a neutral place such as The Hague, for instance, and it may be as a sub-chamber, for example of the Permanent Court of Arbitration, because the latter already have permanent infrastructures and considerable experience. However, the detachment of this institution from any permanent judicial or arbitral forums would be more efficient in order to gain its own reputation.

The institution should provide facilities for arbitration as well as conciliation to all disputes arising out of petroleum transactions whether between petroleum countries or between a state and a petroleum company or petroleum companies. Hence, the jurisdiction of the institution should extend to any disputes arising out of petroleum transactions especially those which invariably arise out of exploitation and exploration agreements between petroleum producing countries and petroleum companies, and it may also extend to any other petroleum or energy i.e. gas disputes.

The institution should have its own procedural rules for arbitration and conciliation, since the petroleum industry is considerably significant to the contracting as well as non-contracting parties and its disputes require urgent decisions, and therefore it is in need to its own rules 6 However, prior to the establishment of such rules and in parallel to having its own rules the institution may use the UNCITRAL Arbitration Rules. At the same time, the institution should apply host state law, but the tribunal would also have the right to decide a dispute with reference to international law, or transnational rules or *ex aequo et bono* if the parties so agree.

The institution might be composed of a number of bodies, i.e. secretariat, a panel of arbitrators, a panel of conciliators and an arbitration court, which would contain people specialized in different fields, such as law, the petroleum sector (qualified petroleum engineers for example) and finance. This court would undertake a supervisory role in terms of arbitrators’ tasks and decisions. Bearing in mind, the institution should have the right to review decisions to terminate a
contract, or to adapt a contract and also to consider these decisions null and void, if the act of the state was not for public purposes or the compensation was inadequate.

The suggested forum or institution would begin by applying the law of the host state. After the accumulation of a body of case law, the institution would introduce its own substantive rules by way of restatement, replacing host state law.

However, it may be asked that whether as a practical matter there would be a sufficient number of disputes to justify establishing a new institution to settle petroleum disputes. Here, it could be argued that the case load of the International Chamber of Commerce (ICC) itself for instance, provides considerable evidence concerning the annual increasing numbers of petroleum disputes concerning the annual increasing numbers of petroleum disputes.

Furthermore, some would say that it is inevitable that such an institution would become politicized very quickly and still others would say that it would be just another bureaucracy, so not very useful or practical. The answer is opposite to these perspectives, since the petroleum industry is one of the most significant industries nowadays and it invariably relies in its development upon steady relationships between its all major actors. Therefore, it could be argued that the institution would not be politicized nor become another bureaucracy, since it would provide its facilities to both governmental and private bodies in which each party would do what-ever necessary to protect its interests such as maintaining a smooth movement of the institution's procedures.

The Energy Charter Treaty (ECT) may provide a successful model for regional arbitration in relation to energy. However, it may be argued that the suggestion for establishment a new institution to undertake the mission of settling energy disputes in general and petroleum disputes in particular is unjustified in the existence of ECT. Here it could be stated that although this argument to some extent appears to be logical, the opposition to this opinion focuses on two reasons: First, the scope of the ECT to some extent is limited to the European territories. Second, the function of the ECT extends the mission of settling disputes to establishing a comprehensive system in all energy aspects. While the sole aim and function of the suggested institution is limited to undertake the mission of settling disputes which invariably arise out of energy (petroleum in particular) transactions disputes. Hence, the suggestion may be well justified.

Finally, the question is whether this system i.e. international treaty or convention, secretariat and options for arbitration or conciliation can be used for petroleum disputes. The answer is yes. However, finding and maintaining an adequate and practical system by which
petroleum disputes in particular and energy disputes in general can be settled, is undoubtedly dependent on the will of the international community to do so especially those countries which are highly concerned about the continuity of this industry.